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Barney Frank's Latest Bad Idea

His new bill would further politicize Federal Reserve decision-making.

By GERALD P. O'DRISCOLL JR.

Rep. Barney Frank (D., Mass.) wants to throw the presidents of the regional Federal Reserve banks off the Fed's policy-making arm. This is a terrible idea that would further politicize the central bank. It is also an idea that was explicitly rejected by the framers of the Federal Reserve Act a century ago—for good reason.

Mr. Frank's bill is simple and remarkably short by Washington standards: two pages. It would strike the language in Section 12A of the Federal Reserve Act that provides for voting membership by the New York Fed and rotating voting membership by the other 11 Federal Reserve banks on the Federal Open Market Committee (FOMC).

Monetary policy is currently set by the seven politically appointed members (governors) of the Fed Board in D.C. and five of the 12 regional presidents. The FOMC is thus already dominated by political appointees. In the past, some governors had strong credentials in the banking or economics profession. They provided independent voices in policy setting and would oppose a Fed chairman. This has been less true over time. Today Fed governors reliably vote with the chairman.

Dissent, if any, will now come from the regional bank presidents. But not just dissent. They can also provide a Fed chairman with the votes needed to conduct good policy. Paul Volcker's anti-inflation policy in the late 1970s and 1980s was importantly backed by the presidents on the FOMC.

Associated Press

Rep. Barney Frank (D., Mass.)

Crucially, the Fed presidents have independent bases in their communities and represent the private sector against Washington political power. They answer to boards made up of bankers, businessmen and public representatives, and they represent regional voices within the Fed system. They are the voices of Main Street, which would go unheeded in the Washington-Wall Street nexus of power and interests that would otherwise dominate monetary policy.

Yet Mr. Frank claimed earlier this week on PBS's "Nightly Business Report" that "to have people who are simply picked by private citizens who have a disproportionate vested interest, for example, in higher interest rates setting this government policy is just undemocratic."

The idea of having a central bank was debated almost from the beginning of the country. Two prototype central banks were created and then abolished in the 19th century. The monetary system of the post-Civil War period had flaws, which were long recognized, and the Panic of 1907 tipped many to the side of creating a central bank. But with what structure?

A number of large banks favored a centralized institution of European design. Almost everyone else opposed that idea. Some opposed a central bank outright, and others wanted some kind of decentralized "bankers' bank." The Federal Reserve Act of 1913 was a compromise. It provided for political oversight in Washington, D.C., and regionalism with 12 banks. The regional banks functioned largely as had the old private clearinghouses, providing services to member (commercial) banks and credit to them when needed.

From the beginning, the 12 presidents provided information about regional conditions and private-sector (not just banking) input into monetary policy. That rankled the centralizers and political appointees in Washington. The institutional tension kept a delicate balance in the Fed for nearly 100 years.

Mr. Frank wants to destroy the Fed's regional characteristics. The only interests to gain from centralization of monetary policy would be the inside Washington power base, and the Wall Street banks that already have great influence within Washington and on monetary policy.

Over the years, the Fed has certainly promised more than it has delivered in price stability and full employment. It has always bent too much to the political winds in Washington. But Mr. Frank's bill does nothing to address those problems. It would, however, increase Washington's political influence on the institution.

The central bank is approaching its 100th anniversary, a good time to consider reform. But the reform should be the product of serious discussion and debate. It should not be an ill-considered change in the Fed's fundamental structure accompanied by political sloganeering about bringing democracy to central banking.

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